



10-1984

Bennett v. Kentucky Department of Education

Lewis F. Powell Jr.

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Probably Grant,
9/22

CA 6 construed Title I of Elementary
& Secondary Education Act of '65 to
allow a state to spend ~~of~~ Fed.
Grant funds on the basis of its
"reasonable" construction of the Act
- though agreed that the Act
read literally was ^{to the} ~~to~~ contrary.
CA 6 ~~has~~ therefore made its
construction retroactive only - not
prospective.

PRELIMINARY MEMORANDUM

September 24, 1984 Conference
Summer List 3, Sheet 2

No. 83-1798

BELL (Sec'y)

v.

KENTUCKY DEP'T OF EDUC.

Federal/Civil

Timely

56 unrec'd grant,
Say this holding is contrary
to our holding in Bell v. U. of
Cert to CA6 (Kennedy,
Merritt, Weick)
Bell v. U. of Case is
important.

1. SUMMARY: Whether a federal agency may recoup grant
funds that it determines to have been misspent by a state where
there is no evidence of bad faith and where the state's program
is based upon the state's own reasonable interpretation of the
law.

2. FACTS AND DECISION BELOW: Title I of the Elementary and
Secondary Education Act of 1965 provides federal funding for

Grant An issue of great importance to the administration
of federal grant programs. David

"meeting the special educational needs of educationally deprived children." 20 U.S.C. §2701. State and local educational agencies obtain federal funds upon providing assurances to the Secretary of Education that the funds will be spent only on qualifying programs and in full compliance with statutory requirements. One of the requirements is that federal funds be used to supplement rather than supplant funds from non-federal sources. The statute provides:

Federal funds made available under this subchapter will be so used (i) as to supplement and, to the extent practical, increase the level of funds that would, in the absence of such Federal funds, be made available from non-federal sources for the education of pupils participating in programs and projects assisted under this subchapter, and (ii) in no case, as to supplant such funds from non-federal sources 20 U.S.C. § 241e(a)(3)(B).

A regulation promulgated under that statute provides:

Each application for a grant ... shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such use of funds under Title I of the Act.... Federal funds made available for that [Title I] project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils.... 45 C.F.R. 116.17(h).

Kentucky established a system of "readiness" instruction, under which educationally deprived children were taught in self-contained classrooms separate from the rest of the school's

pupils during first, and in some cases second, grade. The state, in essence, took the deprived children out of regular classes and placed them in these readiness classes. The entire cost of instruction in readiness classes--as well as part of the cost of administration--was paid for out of Title I funds. Title I children continued to receive "enrichment" services (physical education, music, art, and library) at state expense. The state's allocation of funds to the local education agencies (LEA's) was not reduced.

This case arose when auditors from HEW determined that during FY 1974 50 school districts in Kentucky had spent \$704,000 of Title I grant funds in violation of the prohibition against using such funds to supplant state funds. The basis for that decision was that without federal funding the state would have spent a certain amount of money on instruction of deprived children in the regular classrooms, but after it got the grant it stopped spending any money on their instruction. The state opposed the auditor's recommendation on the ground that there had been no decrease in state or local funding of the schools or grade levels involved.

The Education Appeal Board affirmed the auditor's findings. It framed the question as "whether the statutory and regulatory prohibition against supplanting State and local funds with Title I funds should be measured with reference to expenditure at the level of the LEA, the school, the grade, the classroom or the individual educationally deprived pupil." The Board focused upon language in the statute and regulation emphasized above referring

*State's
argument
launched
in 1974*



to funds available for "educationally deprived children" in reaching its conclusion that "the statutory and regulatory provisions are sufficiently clear in their emphasis on the expenditure of funds for pupils--not LEA's, schools, or grade leels--to sustain the Assistant Secretary's position." The Appeal Board found it clear that there was a decrease in the use of state funds for instruction of Title I children.

The Secretary upheld the Appeal Board's determination that a violation of the supplanting prohibition had occurred. However, he reduced the amount of repayment to \$338,000, based upon the fact that the pupil-teacher ratio in the readiness classes was substantially lower than that prevailing in regular classrooms. The Secretary concluded that the children in readiness classes had therefore received some benefit beyond what they would have received from the regular program.

On appeal, the CA6 rejected respondent's contention that the Secretary lacked authority to require refunds of misspent Title I funds, because that issue was resolved in the Secretary's favor by this Court's decision in Bell v. New Jersey, 51 U.S.L.W. 4647 (1983). It then went on to note resp's contention that no supplanting had occurred (since the LEA's maintained the same number of state-funded regular classroom teachers) and petr's argument that state expenditures on educationally deprived children were reduced. The CA stated:

It cannot be said that the interpretation posited by the Secretary is "unreasonable." The statutory and regulatory prohibitions against supplanting State and local funds with Title I funds can reasonably be applied with reference to expenditures at the level of the individual educationally deprived pupil, rather

than at the level of either the LEA, the school, the grade, or the classroom. Nonetheless, in the instant case we do not feel that it is our task on appeal to review the reasonableness of the Secretary's interpretation We are not reviewing with reference to the future effect of the Secretary's interpretation of a statute. Rather, in this appeal we are concerned with the fairness of imposing sanctions upon the Commonwealth of Kentucky for its "failure to substantially comply" with the [statutory requirements] as those requirements were ultimately interpreted by the Secretary.

The CA disagreed with the Secretary that the statute and regulations were "sufficiently clear to apprise the Commonwealth of its responsibilities under the Act." The CA noted that the legislative history was full of references to Congress' intent to leave to the discretion of the participating states the responsibility to establish programs with Title I funds. The CA acknowledged that the interpretation of the statute posited by the Commonwealth was not controlling and stated that the Secretary's interpretation will govern all future dealings. It continued:

We hold only that in the absence of unambiguous statutory and regulatory requirements, and in the presence of a specific grant of discretion to the Commonwealth to develop and administer programs it believes to be consistent with the intentions of Title I, it is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law.

CA 6's
limited
holdings
- not
applicable
for future

The CA relied in part on Pennhurst I, 451 U.S. 1 (1981), in which the Court stated that if Congress intends to impose a condition on the grant of federal moneys (in that case a duty to provide the "least restrictive treatment" possible to handicapped individuals), it must do so in an unambiguous fashion. The

rationale was that spending power legislation is in the nature of a contract and that the legitimacy of conditions rests on the state's voluntary and knowing acceptance of them. The CA concluded that Kentucky was "unaware of the condition that the Secretary now seeks to impose," and that therefore the Secretary was not justified in assessing a penalty.

3. CONTENTIONS:

Government: The Government argues that its right to recover misspent funds under Bell v. New Jersey is effectively eviscerated by the CA decision. There is no justification for the CA's construction of the Government's recoupment remedy. The crucial issue in a refund proceeding is whether the grant recipient has used federal funds in a manner that violates the terms and conditions of the grant statute and regulations. Despite the CA's conclusion that the Secretary's interpretation of the supplanting provisions was reasonable, the CA refused to allow recoupment. The CA's announcement that the Secretary's interpretation of the supplanting provisions would be given prospective effect highlights the anomaly of the CA's ruling.

yes

It has long been established that agencies may choose to develop interpretations of the law retroactively through adjudication rather than prospectively through rulemaking. SEC v. Chenery Corp., 332 U.S. 194 (1947). The choice between rulemaking and adjudication lies in the agency's discretion. NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974).

There is no reason why the Secretary's right to recoup misspent grant funds should depend upon a showing of bad faith in

its use of funds. The CA was incorrect in its assumption that recovery of the funds constitutes a "penalty." The Secretary is merely attempting to recover monies that were not spent in accordance with the federal statute and regulations.

Finally, nothing in Pennhurst supports the CA's decision. There can be no question that Pennhurst's requirement of legislative clarity does not prevent the Secretary from ensuring that federal funds are spent in accordance with congressional restrictions. No grant recipient could ever have thought otherwise.

The decision below also conflicts with other circuits. For example, the CA4 in West Virginia v. Secretary of Education, 667 F. 2d 417 (1981), stated that where neither the legislative history nor the decisions of the Secretary give any clue as to what the proper interpretation of Title I should be, the Secretary's decision should be given deference and misspent funds should be refunded. Similarly, in Indiana v. Bell, 728 F. 2d 938 (1984), the CA7 sustained the Secretary's finding of an audit deficiency, giving deference to the Secretary's interpretation of Title I, despite the fact that its discussion suggests that at least one of the positions advanced by the state may have met the CA6's standard of reasonableness.

The CA's decision can be expected to have a substantial adverse impact on the Secretary's ability to recoup the approximately \$68 million in currently outstanding Title I audit claims, \$33 million of which are supplanting claims. Moreover, the impact of the decision is not limited to Title I programs; it

would change the ground rules for all manner of federal grant funds.

Respondent:The Government incorrectly frames the issue in this case. The issue is is not whether the Government has a right to recoupment for misspent funds; instead, the issue is what substantive standard is applied to the question whether the state has met its Title I obligations. The substantive standard developed by the Sixth Circuit was that the claim of violation is to be judged by a standard of "fairness." As part of this standard comes the consideration of substantial compliance. The giving of deference to an agency's interpretation of a statute and the consideration of the substantive standard against which a state's actions are to be measured are separate issues. The Government's suggestion that the CA6 decision can be expected to have an adverse impact on not only Title I cases, but other federal grant programs as well is pure sophistry. There is no reason to think that states will be less than honest in handling federal grant programs if there is room to believe such action can be gotten by with. "Suffice it to say States are not crooks waiting for their chance to be dishonest."

Respondent relies (as did the CA6) on Justice White's concurring opinion in Bell v. New Jersey, in which he stated that the cases reviewed in that decision:

... do not involve any question as to the substantive standard by which a claim that a recipient has violated its Title I commitments is to be judged. Rather, they concern the abstract question whether the Secretary has the right to recover Title I funds under any circumstances. In my view there is a significant issue whether a State can be required to repay if it has committed no more than a technical violation of the

agreement or if the claim of violation rests on a new regulation or construction of the statute issued after the State entered the program and had its plan approved. 51 U.S.L.W., at 4653.

4. DISCUSSION: The CA just has to be wrong. If it had concluded that the state's interpretation was more reasonable than the Secretary's but then deferred to the Secretary's interpretation as within the realm of reason, the fairness argument would have more force. Instead, however, it held that because the state's interpretation was within the realm of reason and there was no evidence of bad faith, no refund could be required.

Resp's interpretation of the issue presented in this case is wrong. The CA accepted the conclusion that the substantive standards of Title I had been violated. The question it addressed is the question the SG raises: assuming a failure of substantial compliance with statutory standards, what is the standard under which to determine whether recoupment is to be permitted?

CA 6 agreed Title I was violated

I think it plain that the Secretary's interpretation of Title I is correct. The statute was intended to prevent federal funds from supplanting state funds with respect to Title I children. When the state established the readiness classes, it transferred the economic burden of instruction from itself to the federal government. Although the state continued to spend as much money on education, it did so by increasing the per-pupil expenditure on children in regular classrooms and decreasing the per-pupil expenditure on Title I children. That seems pretty clearly contrary to congressional intent.

It does not seem unfair to require refund of the federal funds that were misspent. Although resp and the CA liken the situation here to that involved in Pennhurst, there is a substantial difference between the two cases. Pennhurst involved the imposition of a new and unexpected obligation on the state. In this case, the state's obligation not to supplant state funds with federal funds was clear. The sole question is whether the particular scheme established by the state constituted supplanting. That kind of judgment is typically made through adjudication, and I seriously doubt that if this were a criminal case there would be much support for the view that it would violate due process to convict under these facts. In this case, however, the Secretary's action was not punitive, but instead remedial. The state was simply required to return funds that the Secretary properly determined were misspent.

The conflict asserted by the SG is far from clear, since the CA's in those cases were apparently not presented with the argument adopted by the CA6 in this case. Although it is possible that the CA6 might have come to a different conclusion than the CA4 and CA7 in the cases cited by the SG, until the other courts explicitly reject the analysis of the CA6 there does not seem to be enough of a conflict to grant simply on that basis.

Justice White's concurring opinion in Bell v. New Jersey is not that helpful to respondent's position. The state's violation in this case can hardly be called "technical." Moreover, this case involves a new construction of the statute only in the sense

that no one had ever violated it in quite this way before; it is not a case where the state implemented its plan based upon reliance on a construction of a statute that was later modified.

The SG is correct that the analysis employed by the CA could have dramatic implications for any number of federal spending programs. In order to avoid the obligation to repay funds, the state need not be right; it need only be reasonable. The facts of this case highlight the problem. The Secretary's interpretation of the statute and regulations is the most reasonable, but because the state's position is one that could be made with a straight face, recoupment was not allowed. Given that there will seldom be evidence of bad faith, the recoupment remedy allowed in Bell v. New Jersey may not mean much after this decision.

5. RECOMMENDATION: I recommend granting the petn.

There is a response.

June 21, 1984

Browne

Opin in petn.

file
December 27, 1984

BELL GINA-POW

83-1798 Bell, Secretary of Education v. Kentucky
Department of Education(CA6)

MEMO TO FILE

This case arises under Title I of Elementary and Secondary Education Act of 1965 - a statute providing federal financial assistance for programs "which contribute particularly to meeting the special educational needs of educational deprived children" in areas where there are high concentration of children from low income families. The funds are intended to benefit this special group of children. The federal funds are made available to be administered by the states subject to regulations adopted by the Secretary of Education.

In addition to requiring that Title I funds are used only to provide supplemental assistance for the education of deprived children in low income areas, the regulations also purport to assure that the federal funds are used to supplement and not supplant state and local funds that otherwise would have been spent on the particular pupils in the special education programs.

The Act provides for auditing of the states expenditure of the funds. In this case the auditor concluded that federal funding had replaced the state and local funds that otherwise would have been spent on first or second grade children in "readiness classes". Such classes differed somewhat from other supplementary education provided in subjects such as mathematics, the English language, etc.. The "readiness classes" were for slow learners who needed special tutoring help in order to be promoted from first and second grade. In any event, the auditors concluded that the state had misspent \$704,000 - a figure subsequently reduced by the Secretary to some \$300,000. The Federal Government sought a refund of money misspent. Kentucky's appeal was rejected by the Appeals Board and by the Secretary.

CA6 reversed decisions by the Appeals Board of the Department of Education and by the Secretary. The Court of Appeals acknowledged that the regulations were "reasonable" but thought they were ambiguous, and found that the State had not acted in "bad faith" when it adopted a different interpretation that also was reasonable. Therefore, CA6 held that although the

Secretary's regulations would apply for the future, the State could not be required to repay the misspent funds.

The SG argues strongly and persuasively that the court's decision is erroneous and could have an unfortunate precedential effect. Where Congress has specifically authorized an agency or a department to adopt regulations, and where the Secretary - acting within his authority - has approved the regulation as reasonable, the court should not conclude that they may not be followed if viewed as ambiguous and where the state has not acted in bad faith.

Although one can be sympathetic to the State's position, I also am impressed by the SG's argument that the state at least - in view of the alleged ambiguity of the regulations - should have requested a ruling from the Department of Education before misapplying .

* * *

Subject to more careful consideration of this case and to the arguments, I am inclined to reverse. I should say, however, that I think the Attorney General of Kentucky has filed a well-written brief that presents non-frivolous arguments. It is much better than the usual brief from Kentucky.

Unless my clerk has a different view (that I would welcome), a summary memo will suffice.

* * *

Note to my Clerk: Case No. 83-2064, Bell, Secretary of Education v. State of New Jersey, also is to be argued at the January Session. I believe these two cases are to be argued back to back, as both involve Title I of the Education Act. The issues are different, but it may be desirable that the same clerk be responsible for both cases.

LFP, JR.

83-1798 BELL v. KENTUCKY

Argued 1/8/85

The Chief Justice

Justice Brennan

Justice White

Justice Marshall

Justice Blackmun

Justice Powell

Justice Rehnquist

Justice Stevens

Justice O'Connor

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

February 15, 1985

Re: 83-1798 - Bell v. Kentucky Dept. of Ed.
83-2064 - Bell v. New Jersey

Dear Sandra:

In the Kentucky case you have written a fine opinion which I expect to join. However, since I remain unpersuaded in the New Jersey case and will be writing a dissent, I will not join the Kentucky case until I have completed my dissent in the other case.

Respectfully,

Justice O'Connor

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE Wm. J. BRENNAN, JR.

February 15, 1985

No. 83-1798 -- Bell v. Kentucky

Dear Sandra:

Please join me.

I have one question, however, concerning the first sentence on page 13. You define the recoupment inquiry in terms of conditions existing "at the time the grants were made." I generally agree, but believe that the point when the State actually expends the money may also be relevant. Many Government grants are made for the forthcoming year; I can well imagine circumstances in which the Government might be able to adjust or clarify requirements after "the grants were made" but before the funds were actually expended. In light of the number of recoupment cases pending in federal courts, this might be a significant distinction. I'd prefer to keep the standard just a bit more ambiguous. What would you think of revising the sentence to read: "... at the time the grants were made and the funds expended"? If you agree, this might require a comparable revision to the last sentence in Part III.

In any event, I'll be happy to defer to your expertise and decision either way.

Sincerely,



Justice O'Connor

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE SANDRA DAY O'CONNOR

February 15, 1985

No. 83-1798 Bell v. Kentucky

Dear Bill,

I agree that it is desirable to leave somewhat ambiguous the precise time that determines the correct legal standards for evaluating compliance with the requirements of Title I. In this regard, my use of the phrase "when the grants were made" is deliberate. This phrase could refer to the time when the state education agency approved applications submitted by local school districts, received federal funds from the Secretary, or disbursed funds to local education agencies for approved programs. See 20 U.S.C. §241e(a) (1976 ed.) (referring to receipt of grant by local education agency); id. §241g(a)(1) (payment of funds to State); id. §241g(a)(2) (distribution of funds by state education agency to local education agencies for approved applications).

Thus, I believe that the phrase "when the grants were made" would allow the Federal Government to clarify the requirements after a state education agency approved applications but before the state agency actually distributed federal funds to local school districts. Title I funds were to be expended within a two-year period. See 20 U.S.C. §1225(b). I would prefer to avoid the issue whether a State may be found liable where the actual expenditures for a local program conformed to requirements in place when the State approved the application and distributed the funds, but did not satisfy a requirement or clarification adopted after the money was out of the hands of the state education agency. The phrase "when the grants were made," I acknowledge, might suggest a negative answer. On the other hand, addition of the language "and the funds expended" would seem clearly to indicate that the State could be liable. Consequently, I am presently inclined to stick with "when the grants were made."

Sincerely,



Justice Brennan

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

February 18, 1985

83-1798 -

Bell v. Kentucky Department of Education

Dear Sandra,

I join all but Part III of your circulating draft. In light of Part IV, Part III seems unnecessary, and I have some doubts about it besides.

Sincerely yours,



Justice O'Connor

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

February 19, 1985

Re: No. 83-1798 Bell v. Kentucky Department of Education

Dear Sandra,

Please join me.

Sincerely,



Justice O'Connor

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

February 21, 1985

Re: No. 83-1798-Bell v. Kentucky Dept. of Ed.

Dear Sandra:

Please join me.

Sincerely,

J.M.

T.M.

Justice O'Connor

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

February 28, 1985

Re: 83-1798 - Bell v. Kentucky Dept. of
Education

Dear Sandra,

Please join me.

Respectfully,



Justice O'Connor

Copies to the Conference

March 1, 1985

83-1798 Bell v. Kentucky Department of Education

Dear Sandra:

Please add at the end of your opinion that I took no part in the consideration or decision of this case.

Sincerely,

Justice O'Connor

lfp/ss

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

March 4, 1985

Re: No. 83-1798 - Bell v. Kentucky Department of Education

Dear Sandra,

I join.

Regards,

A handwritten signature in black ink, appearing to be "O'Connor", written in a cursive style.

Justice O'Connor

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

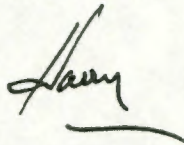
March 5, 1985

Re: No. 83-1798, Bell v. Kentucky Dept. of Education

Dear Sandra:

I am where Byron is in this case. I, therefore, join
your opinion except for Part III.

Sincerely,

A handwritten signature in cursive script, appearing to read "Harry", with a horizontal line underneath.

Justice O'Connor

cc: The Conference

83-1798 Bennett v. Kentucky Dept. of Education (Rory

LFP out 3/1/85

SOC for the Court 1/18/85

1st draft 2/14/85

2nd draft 3/6/85

3rd draft 3/7/85

Joined by WJB 2/15/85

WHR 2/19/85

BRW joins all but Part III 2/18/85

TM 2/21/85

JPS 2/28/85

CJ 3/4/85

HAB joins all except Part III

3/5/85

JPS will dissent 2/15/85